

CURRENT CONCEPTIONS OF TAXABLE INCOME

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Now that fifty years have passed since the adoption of the sixteenth amendment and the enactment of the first income tax under that amendment, it is an appropriate time to consider what progress we have made in the solution of a basic problem under the tax: what is taxable as income?

The complete answer to this question will not be found in the Code, which makes no attempt to lay down a general definition of taxable income in the sense of what is taxable as income.¹ Section 61(a) of the 1954 Code declares: "Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including but not limited to the following items: . . ." Although section 61(a) and its predecessor, section 22(a) of the 1939 Code, are frequently referred to as a legislative attempt to define taxable income, it is obvious that a definition of income in terms of itself would not be particularly revealing. Actually, of course, section 61(a) does not attempt to define taxable income, but simply indicates one of the steps in computing the income tax. Gross income in the statutory sense is the amount of income which furnishes the starting point for the computation of the income tax, after subtracting exclusions from gross income from gross receipts. Although the statute does not contain any general definition of taxable income, it does list a number of specific items which are included in² or excluded from³ gross income, and to this extent it indicates what is and what is not taxed under the income tax in most of the more common situations. The definition of what is taxable as income in the situations not specifically covered by the statute, however, is left to the Treasury and the courts.

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¹ "Taxable income" is used in this discussion in the sense of the income that may be taxed under an income tax rather than in the sense of net income, the meaning given to the expression "taxable income" under § 63 of the 1954 Code.

² Int. Rev. Code of 1954, §§ 61, 71-78.

³ Int. Rev. Code of 1954, §§ 101-119.

At one time the Supreme Court attempted to construct a general definition of taxable income.⁴ However, it soon abandoned this effort⁵ in favor of an *ad hoc* approach under which the existence of taxable income must be found in the particular circumstances of the specific case.⁶ Beyond paraphrasing the statutory definition of gross income, the Treasury Regulations do not attempt any general definition of taxable income. This does not mean, however, that there are no guidelines as to what constitutes taxable income. Although there is no single authoritative definition of taxable income, the general pattern of the cases reveals the judicial attitude toward the income tax and affords a surer clue to what may be taxed as income than any formal definition. Although the Supreme Court cases are not the only reflection of the judicial attitude, they are typical, and in the limited space available here must be our principal reliance.

The key to what the Supreme Court currently conceives to be taxable income lies in the radical reversal of its attitude toward the income tax. This hostility, which first expressed itself in the *Pollock* case,⁷ where the Court struck down the 1894 tax, carried over after the sixteenth amendment.⁸ By construing the amendment narrowly and attempting to set up a constitutional definition of income to which Congress had to conform,⁹ the Court sought to control the tax which it had striven unsuccessfully to outlaw entirely. As time passed, however, and the Court became reconciled to the tax, its attitude changed.¹⁰ Today the Court's tolerance of the tax has reached the point where it would be very surprising if anything which there was a reasonable basis for taxing under the income tax was found to be beyond Congress' constitutional competence.¹¹ As

⁴ *Eisner v. Macomber*, 252 U.S. 189 (1920).

⁵ In *Kirby Lumber Co. v. United States*, 284 U.S. 1, 3 (1931), Mr. Justice Holmes declared that there was "nothing to be gained by the discussion of judicial definitions" of income.

⁶ In *Commissioner v. Wilcox*, 327 U.S. 404, 407 (1946), the Court said: "In fact, no single, conclusive criterion has been found to determine in all situations what is a sufficient gain to support the imposition of an income tax. No more can be said in general than that all relevant facts and circumstances must be considered."

⁷ *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 158 U.S. 601 (1895).

⁸ See, for example, *Towne v. Eisner*, 245 U.S. 418 (1918); *Eisner v. Macomber*, *supra* note 4; *Edwards v. Cuba R.R. Co.*, 268 U.S. 628 (1925).

⁹ *Eisner v. Macomber*, *supra* note 4.

¹⁰ See, for example, *Burnet v. Wells*, 289 U.S. 670 (1933); *Helvering v. Bruun*, 309 U.S. 461 (1940); *Helvering v. Horst*, 311 U.S. 112 (1940).

¹¹ Compare the Court's attitude toward the constitutionality of subjecting stock dividends to the income tax in *Eisner v. Macomber*, *supra* note 4, and in *Helvering v. Griffiths*, 318 U.S. 371 (1943).

far as construction is concerned, the Court's conception of taxable income has grown correspondingly generous and flexible.¹²

In connection with the Supreme Court's present posture with regard to the income tax, there is a pertinent parallel in the reversal of its attitude toward the estate tax. Originally, the Court was inimical toward the estate tax. Although it never went to the extreme of holding the estate tax unconstitutional,¹³ as it did the income tax, it did everything it could to hamper the effective administration of the tax. The Justices strove to limit the application of the tax by construing the statute in a way that not only ignored the literal wording of the statute,¹⁴ but also rejected the legislative background behind the wording.¹⁵ When construction failed to frustrate the tax, the Court struck down particular provisions by inventing constitutional limitations which restricted the estate tax to "testamentary transfers"¹⁶ and inhibited the retroactive application of the tax to transfers effected before the provision taxing such transfers was enacted.¹⁷ Later, however, when the Court became reconciled to the estate tax the judicial climate changed dramatically. The Court proceeded to demolish the constitutional barriers it had erected against the tax, and held that any kind of transfer was taxable constitutionally under the tax as long as there was a rational basis for taxing it.¹⁸ Moreover, it construed the statute generously, stretching the statutory language as far in favor of the

¹² *James v. United States*, 366 U.S. 213 (1961); *Commissioner v. LoBue*, 351 U.S. 243 (1956); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); *General American Investors Co. v. Commissioner*, 348 U.S. 434 (1955).

¹³ *Knowlton v. Moore*, 178 U.S. 41 (1900) upheld the constitutionality of a federal inheritance tax. *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921) sustained the federal estate tax.

¹⁴ *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); *Shukert v. Allen*, 273 U.S. 545 (1927).

¹⁵ In *May v. Heiner*, 281 U.S. 238 (1930) the Supreme Court held that a transfer with a reservation of a life interest was not taxable as a transfer "intended to take effect in possession and enjoyment at or after" death, despite the fact that Congress borrowed this phrase from state inheritance taxes, where it was construed uniformly to include such transfers. Other examples of the Court's attempt to limit the estate tax by hostile construction include: *Helvering v. St. Louis Union Trust Co.*, 296 U.S. 39 (1935); *Becker v. St. Louis Union Trust Co.*, 296 U.S. 48; and *White v. Poor*, 296 U.S. 98 (1935).

¹⁶ *Heiner v. Donnan*, 285 U.S. 312 (1932).

¹⁷ *Nichols v. Coolidge*, 274 U.S. 531 (1927).

¹⁸ *Helvering v. City Bank Farmers' Trust Co.*, 296 U.S. 85 (1935) and *Helvering v. Bullard*, 303 U.S. 297 (1937) repudiated the idea that only "testamentary transfers" may be taxed under the estate tax. Although *Jacobs v. United States*, 306 U.S. 363 (1939) did not directly overrule *Nichols v. Coolidge*, *supra* note 17, it came very close to it as far as the results of the cases are concerned.

government¹⁹ as it had formerly compressed it in favor of the taxpayer.

Of course, the change in the Supreme Court's attitude toward the estate and income taxes was not accidental and unpremeditated. It seems obvious that the Justices were not so enamored with their own legal logic that they really felt they were inexorably bound to hold that the income tax as applied to income from property was a direct tax which was unconstitutional because it was not apportioned, or that only testamentary transfers could be taxed under the estate tax. The thing which excited their antagonism against the income and estate taxes was the social philosophy behind the taxes—the progressive feature of the taxes, with the consequent emphasis on “soaking the rich” or taxing the taxpayer according to his ability to pay—whichever way one chooses to phrase it. As the “rugged individualism” of the Court became muted in the crescendo of social innovation which characterized political developments in this country after World War I, the Supreme Court's attitude changed along with that of most of the citizenry and their political leaders. The Court recognized progressive taxes as a permanent feature of the fiscal scene and decided to accommodate itself to them by giving full freedom to the legislature to formulate its own fiscal patterns.

There has been a curious reversal in Congress' attitude in connection with the estate and income taxes, which has paralleled the change in the Court's attitude, except that it has gone in the opposite direction. As the Supreme Court has become increasingly liberal about taxing income and estates, Congress has grown increasingly conservative. This trend is clearly perceptible in connection both with the estate tax²⁰ and the income tax.²¹ Conse-

¹⁹ *Helvering v. Hallock*, 309 U.S. 106 (1940) overruled the *St. Louis Union Trust Co.* cases, *supra* note 15, and *Spiegel's Estate v. Commissioner*, 335 U.S. 701 (1949) pushed the *Hallock* case so far that Congress repudiated the *Spiegel* case in the Technical Changes Act of 1949, 63 Stat. 891 (1949). Nearly twenty years after the decision in *May v. Heiner*, *supra* note 15, and the amendment of the statute to tax transfers with a reservation of a life estate explicitly, the Supreme Court suddenly overruled *May v. Heiner* in *Commissioner v. Church's Estate*, 335 U.S. 632 (1949), inspiring Congress to reject the *Church* case. Technical Changes Act of 1949, *supra*. See also *Commissioner v. Holmes' Estate*, 326 U.S. 480 (1946) and *Lober v. United States*, 346 U.S. 335 (1953).

²⁰ See, for example, Congress' rejection of the Supreme Court's decisions in *Spiegel's Estate v. Commissioner* and *Commissioner v. Church's Estate*, *supra* note 19; the marital deduction (Int. Rev. Code of 1954, § 2056); and the abolition of the premium payment test for taxing life insurance to the estate of the insured. Int. Rev. Code of 1954, § 2042.

²¹ To cite but a few examples: when the Supreme Court held in *Helvering v. Bruun*, *supra* note 10, that a lessor realized income from improvements made to the

quently, as the Court has extended the definition of taxable income, Congress has tended to contract it.

The real definition of taxable income is not found in formal definitions, but in the attitude of Congress and the courts toward what is, and what may be, taxed under the income tax. It is time to document these generalities with specifics.

Source of Income

An interesting illustration of how the Supreme Court's attitude changed toward the income tax is found in its treatment of the constitutional barriers to taxing income because of the source of the income. In *Pollock v. Farmers' Loan & Trust Co.*²² the Court discovered two constitutional objections to the 1894 income tax. The first was that as applied to income from property, the tax was in substance a tax on the source of the income, and a direct tax on property which was unconstitutional because it was not apportioned. The second fatal defect of the tax was that as applied to interest from state and local bonds it imposed an unconstitutional burden on the borrowing power of the states. As far as the literal language of the sixteenth amendment is concerned, it meets both of the objections advanced in the *Pollock* case. The amendment provides: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." This would appear to empower Congress to impose an unapportioned income tax and to tax income regardless of the source of the income. Shortly after the amendment was adopted, however, the question arose in *Peck & Co. v. Lowe*.²³ as to whether the federal income tax could be applied constitutionally to the income of an exporter or whether it was a prohibited tax on exports.

leased premises by the lessee when the lease terminated, Congress explicitly excluded such income from the income tax. Int. Rev. Code of 1954, § 109. The taxation of employee stock options by the Supreme Court [*Commissioner v. LoBue*, 351 U.S. 243 (1956) and *Commissioner v. Smith*, 324 U.S. 177 (1945)] has been accompanied by the legislative evolution of the restricted stock option exempting such income from the income tax in Int. Rev. Code of 1954, § 421. After the Supreme Court held that an unharvested crop was not a capital asset which resulted in a capital gain when sold in conjunction with the land on which it was grown [*Watson v. Commissioner*, 345 U.S. 544 (1953)] Congress nullified this decision by providing that such gains should be taxed as capital gains by enacting Int. Rev. Code of 1954, § 1231. Section 108 of the 1954 Code provides for the exclusion from gross income of gain from the cancellation of a debt, which was held to be taxable as income in *Kirby Lumber Co. v. United States*, *supra* note 5, and *Commissioner v. Jacobson*, 336 U.S. 28 (1949).

²² *Supra* note 7.

²³ 247 U. S. 165 (1918).

Passing over the comma between "from whatever source derived" and "without apportionment among the several states," the Supreme Court declared that the amendment simply relieved Congress from the obligation of apportioning an income tax because of the source of the income taxed. It did not confer any substantive power on Congress to tax income from sources that it could not reach before the adoption of the amendment. The Court thus went out of its way to construe the amendment as narrowly as possible, since it finally held that the tax in *Peck & Co. v. Lowe* upon income from exporting was too far removed from the source of the income to be a tax upon exports. Consequently, the digression about whether Congress had power under the sixteenth amendment to tax income irrespectively of the source of the income had no direct bearing upon the ultimate disposition of the case.

By refusing to construe the sixteenth amendment to authorize Congress to tax income regardless of the source of the income, the Court laid the foundation for the later holding that the federal income tax as applied to the salary of a federal judge appointed before the enactment of the tax was unconstitutional, because it violated the prohibition against reducing judges' stipends during their term of office.²⁴ The Court also held that it was unconstitutional to impose the federal income tax on compensation of state officers and employees.²⁵

As soon as it completed the carpentry on these constitutional obstacles, the Court proceeded to demolish them. The exemption of compensation of state officers and employees had already encountered doctrinal difficulties due to judicial attempts to limit the immunity to state officers and employees, as distinguished from independent contractors,²⁶ and to confine it to officers and employees engaged in performing essential governmental functions for a state.²⁷ The distinctions between an independent contractor and an officer and employee, and between proprietary and governmental

²⁴ *Evans v. Gore*, 253 U.S. 245 (1920). In *Miles v. Graham*, 268 U.S. 501 (1925) the Supreme Court held that income of a judge appointed after the enactment of the federal income tax could not be subjected to the tax, because this would make his compensation uncertain and the constitutional guaranty against reducing a judge's stipend implied a certain stipend.

²⁵ *Brush v. Commissioner*, 300 U.S. 352 (1937).

²⁶ *Metcalf & Eddy v. Mitchell*, 269 U.S. 514 (1926). It was not easy to distinguish between an independent contractor and an officer or employee of a state. Compare *Register v. Commissioner*, 69 F.2d 607 (5th Cir. 1934) with *Burnet v. Livezey*, 48 F.2d 59 (4th Cir. 1931), involving attorneys employed by a state, and *Underwood v. Commissioner*, 56 F.2d 67 (4th Cir. 1932) with *Halsey v. Helvering*, 57 F.2d 234 (D.C. Cir. 1934) involving engineers employed by a state.

²⁷ *Helvering v. Powers*, 293 U.S. 214 (1935).

functions of a state became so blurred that it was impossible to predict the result in a borderline case. At the height of this confusion the Supreme Court came to the rescue by discarding the immunity entirely and holding that there was no constitutional prohibition against subjecting the salary of a state officer or employee to the federal income tax, since the tax did not impinge directly upon the governmental employer and there was no way of showing that the burden of the tax was shifted to the governmental employer.²⁸ Shortly afterwards, it was held that there is no constitutional inhibition against taxing salaries of federal judges under the income tax.²⁹ The Court adopted the position of Mr. Justice Holmes who, dissenting in *Evans v. Gore*,³⁰ had pointed out that the purpose of the constitutional provision against reducing judicial stipends was to assure independence of the judiciary against the legislature, and there was no chance that this independence would be infringed by a general income tax.

Although the Supreme Court has never explicitly abandoned the position it took in *Peck & Co. v. Lowe*,³¹ when it asserted that the sixteenth amendment did not confer power on Congress to tax income from sources which it could not reach before the amendment, it is clear that the attitude of the Court has relaxed considerably since that decision. Apparently Congress does have power to tax income "from whatever source derived." The only situation where doubt remains about congressional power to tax income because of the source of the income is in connection with a federal income tax on interest from state bonds. There is no conclusive authority as to the constitutionality of such a tax. The only case where the Supreme Court squarely held that Congress lacked power to tax interest from state and local bonds was the *Pollock* case,³² which was, of course, decided before the sixteenth amendment. The modern federal income taxes have all carried an explicit exemption of interest from state and local bonds which has prevented any question about the constitutionality of a tax upon such interest from arising.³³ In several cases the Supreme Court held that provisions of the income tax which did not directly impinge on interest from state bonds, although they indirectly affected such

²⁸ *Helvering v. Gerhardt*, 293 U.S. 214 (1935).

²⁹ *O'Malley v. Woodbrough*, 307 U.S. 277 (1939). See *Baker v. Commissioner*, 149 F.2d 342 (4th Cir. 1945), *cert. denied*, 326 U.S. 746 (1945).

³⁰ *Supra* note 24.

³¹ *Supra* note 23. But see the concurring opinion of Black, J., in *Helvering v. Gerhardt*, *supra* note 28.

³² *Supra* note 7.

³³ Int. Rev. Code of 1954 § 103(a) (1).

interest or a gain from the sale of the bonds, were constitutional.³⁴ The care which the Court took to distinguish these cases from a tax upon interest from state bonds might indicate a belief that such a tax would be unconstitutional. *Helvering v. Gerhardt*,³⁵ which held that the federal income tax could be applied constitutionally to salaries of state employees is not directly in point, because that decision was grounded upon the proposition that it could not be demonstrated that the burden of such a tax would be shifted to the governmental employer. There is a considerable accumulation of economic data to the effect that subjecting interest from state and local bonds to the federal income tax would require the states and local units to pay higher interest on their obligations. The case closest in point is *Alabama v. King & Boozer*,³⁶ where the Supreme Court held that a state sales tax could be applied constitutionally to sales to a contractor engaged in building an army camp for the federal government under a cost-plus-fixed-fee contract. The Court said that since the legal incidence of the tax was on the contractor, the fact that the burden of the tax might be shifted to the governmental employer was immaterial. The rationale of this decision would clearly sustain the constitutionality of a federal income tax on the interest from a state bond. The tax is formally imposed not upon the governmental borrower, but upon the individual bondholder, and if the ultimate economic incidence of the tax is immaterial, the tax is clearly constitutional. Of course, *King & Boozer* involved a sales tax, not an income tax. It would require no great judicial agility for the Supreme Court to distinguish the case from that of an income tax. Here is where the attitude of the Court becomes important. It is practically inconceivable that the present Court, with its friendly tolerance of the income tax and its cognizance of federal fiscal needs, would hold that taxing interest from state bonds under the federal income tax was unconstitutional.

Definition of Taxable Income

At approximately the same time that the Supreme Court was seeking to keep some measure of control over the income tax by construing the sixteenth amendment in a way that gave the Court the final say about what sources of income might be taxed, it took further steps to secure control of the tax by laying down a definition

³⁴ *Willcuts v. Bunn*, 282 U.S. 216 (1931) (tax on gain from sale of state bonds); *Denman v. Slayton*, 282 U.S. 514 (1931) (denial of deduction for interest incurred on loan to purchase state bonds); *Flint v. Stone Tracey Co.*, 220 U.S. 107 (1911) (federal excise on corporations measured by interest from state bonds).

³⁵ *Supra* note 28.

³⁶ 314 U.S. 1 (1941).

of taxable income. In *Eisner v. Macomber*³⁷ the Court held that the 1916 act, which explicitly taxed stock dividends as income, was unconstitutional as applied to a dividend of common on common, since the stockholder had not realized any income from the dividend. Although *Eisner v. Macomber* never lived up to its prospective potential, it was a subtle and far-reaching decision. By laying down a constitutional definition of income, the Court created the impression that only income in the sense in which the term was used in the sixteenth amendment could be reached under the federal income tax. Furthermore, by specifying three essential ingredients of income in the constitutional sense, it limited the items taxable as income under the federal income tax to those possessing the three magic ingredients.

It seems clear, however, that the federal income tax might be applied constitutionally to a gain which is not income in the sense in which that term is employed in the sixteenth amendment. Congress does not derive its power to tax from the sixteenth amendment. It had plenary power to tax anything before the amendment was adopted. The Supreme Court did not question the power of Congress to tax income or any other gain in the *Pollock* case.³⁸ The *Pollock* case held that the 1894 income tax was unconstitutional as far as the tax applied to the income from property, not because it was a tax which Congress lacked power to impose, but because in substance it was a tax upon the property which produced the income, and was a direct tax which had to be apportioned. The sixteenth amendment simply relieves Congress from the necessity of apportioning an income tax which is regarded as a direct tax. It does not in any way circumscribe congressional power to tax income from some source other than property (such as compensation for services) where the tax would not be a direct tax. Nor does it prevent Congress from taxing a gain which is not income (if there be such a gain) in the constitutional sense, provided that the tax is not a direct tax.³⁹ The opinion in *Eisner v. Macomber*, consciously or unconsciously, tended to obscure this. For example, in *Edwards v. Cuba R.R. Co.*,⁴⁰ the Supreme Court held that subsidies paid to the Cuba Railroad by the Cuban government in return for building a railroad in Cuba were not taxable as income of the railroad, but constituted a contribution to capital. After reaching this conclusion, the Court added that the subsidies did not constitute "income within the meaning of the sixteenth

³⁷ *Supra* note 4.

³⁸ *Supra* note 7.

³⁹ *Spreckles Sugar Refining Co. v. McClain*, 192 U.S. 397 (1904).

⁴⁰ 268 U.S. 628 (1925).

amendment.”⁴¹ Apparently the impression which Mr. Justice Butler sought to convey by this cryptic comment was that any attempt to tax the subsidies under the income tax would be unconstitutional. It is difficult to see why this should be so. Even conceding that a contribution to capital is not income in the constitutional sense, a tax upon an accession of this kind would appear to be an indirect tax upon the transfer of the contribution to capital to the recipient of the transfer. It is difficult to see any basis for holding that it is a direct tax.⁴² If the tax is not a direct tax, the only possible objection to taxing a contribution to capital under the income tax (since presumably constitutionality involves something more fundamental than a quibble about labels) would be that this involves some sort of unreasonable classification that offends due process. It seems plain, however, that if a contribution to capital is not income, it is a kind of gain that approaches income closely enough to be reasonably taxable under an income tax. The recent difficulties which the courts have encountered in determining what constitutes a contribution to capital are ample evidence of this.⁴³ Of course, the current code excludes contributions to the capital of a corporation from gross income. Despite *Edwards v. Cuba R.R. Co.*, however, it does not appear that this exclusion is compelled by constitutional considerations.

Although there is considerable confusion in the cases, it would appear that the only time it is necessary to resort to the sixteenth amendment to justify taxing a gain under the federal income tax is when the tax on the gain is regarded as a direct tax, which must be apportioned unless it can be brought under the sixteenth amendment. The sixteenth amendment does not, as *Edwards v. Cuba R.R. Co.*⁴⁴ intimated, limit the federal income tax to gains which constitute income in the sense in which that term is used in the amendment. It is true that section 61(a) of the 1954 Code defines gross income as “all income from whatever source derived,” and presumably limits the tax to income in the sense in which that term is employed in the sixteenth amendment. Moreover, the earlier laws which defined gross income as “gains or profits and

⁴¹ *Id.* at 633.

⁴² There is an obvious analogy between such a tax and the taxes on testamentary and inter vivos transfers of capital which were held to be indirect taxes in *Knowlton v. Moore* and *New York Trust Co. v. Eisner*, *supra* note 13, and *Bromley v. McCaughn*, 280 U.S. 124 (1929).

⁴³ *Teleservice Co. v. Commissioner*, 254 F.2d 105 (3d Cir. 1958).

⁴⁴ *Supra* note 40.

income derived from any source whatever" also limited the tax to income in the constitutional sense, since both Congress and the Supreme Court have indicated that "gains or profits" were synonymous with "income" and added nothing to that description.⁴⁵ The fact that only income is taxed under the general statutory definition of gross income does not mean, of course, that it would not be constitutionally possible to tax a gain which is not income under the income tax. Nor, for that matter, would it necessarily prevent taxing an item specifically mentioned by the statute, since presumably the specific designation would control the more general description. Where, for example, the Internal Revenue Code or some ancillary legislation specifies in connection with a statute regulating prices that overceiling prices paid for goods sold by a taxpayer shall not be deductible in computing his taxable gain from the sales, the deduction of the overceiling prices should be disallowed, despite the fact that one may feel that the gain from the sales without this deduction does not meet the general description of income.⁴⁶ Moreover, it would appear that disallowance of the deduction would be fully constitutional if the tax on the gross proceeds of the sales could be fairly regarded as an indirect tax on the sales rather than a direct tax which requires apportionment,

⁴⁵ This was indicated in the Committee Reports accompanying the 1954 Code where it was stated that "income" in § 61(a) of the 1954 Code had the same meaning as "gains or profits and income" in § 22(a) of the 1939 Code. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A18; S. Rep. No. 1622, 83d Cong., 2d Sess. 168. For the Supreme Court's position see the discussion of *Commissioner v. Glenshaw Glass Co.*, *supra* note 12, at p. 166 *infra*.

⁴⁶ In the absence of a statutory provision forbidding the deduction of overceiling prices in computing the cost of goods sold, it has been held that this cannot be required, since the statute taxes net income. *Commissioner v. Guminski*, 198 F.2d 265 (5th Cir. 1952); *Jones v. Herber*, 198 F.2d 544 (10th Cir. 1952); *Hofferbert v. Anderson Oldsmobile, Inc.*, 197 F.2d 504 (3d Cir. 1952); *Commissioner v. Weisman*, 197 F.2d 221 (1st Cir. 1952); *Lela Sullenger*, 11 T.C. 1076 (1948). The *Sullenger* case suggested that it would be unconstitutional to deny the deduction of the overceiling prices, a proposition questioned by Magruder, J., in his concurring opinion in the *Weisman* case. Magruder suggested that a tax on a merchant's gross receipts would be an indirect tax under *Spreckles Sugar Refining Co. v. McClain*, *supra* note 39, which would be constitutional as an indirect tax not requiring apportionment apart from the sixteenth amendment. A statute forbidding the deduction of overceiling wage payments in computing the cost of goods sold for income tax purposes has been held constitutional. *Solon Decorating Co. v. Commissioner*, 253 F.2d 424 (6th Cir. 1958); *Pedone v. United States*, 151 F. Supp. 288 (Ct. Cl. 1957); *N. A. Woodworth Co. v. Kavanaugh*, 102 F. Supp. 9 (E.D. Mich. 1952), *aff'd*, 202 F.2d 154 (6th Cir. 1953); *Weather-Seal Mfg. Co. v. Commissioner*, 199 F.2d 376 (6th Cir. 1952).

regardless of whether or not the tax was a tax upon income in the sense in which that term is used in the sixteenth amendment.⁴⁷

Although the Supreme Court soon abandoned any attempt to lay down a general constitutional definition of taxable income, the erroneous impression persisted after *Eisner v. Macomber*,⁴⁸ and probably still lingers in some minds, that only income in the sense in which that term is used under the sixteenth amendment may be taxed constitutionally under the income tax.⁴⁹ Moreover, for many years the courts struggled with the three specific requisites for taxable income that were laid down in *Eisner v. Macomber*. That case defined income "as the gain derived from capital, from labor, or from both combined." The three essential ingredients of income prescribed by that decision were, therefore: (1) a gain, (2) derived or realized, (3) from capital or labor or both combined. Perhaps the most accurate index of the changed attitude of the Supreme Court toward the income tax lies in the extent to which it has been willing to dispense with these elements in finding taxable income.

Gain

The only element of income prescribed by *Eisner v. Macomber* that still appears to be required is gain. Gain persists as an essential element of taxable income, but it is an attenuated gain, gain in a special Pickwickian tax sense.

The gain which will sustain an income tax may take any form from which the taxpayer can derive an economic, or perhaps even an emotional satisfaction. Income may be realized in kind as well as cash. Thus accommodations furnished an employee for the convenience of the employee constitute income to the employee.⁵⁰

⁴⁷ See the concurring opinion of Magruder, J., in *Commissioner v. Weisman*, *supra* note 46, and *Spreckles Mfg. Co. v. McClain*, *supra* note 39. See also *Nicol v. Ames*, 173 U.S. 509 (1899). In upholding the application of the federal income tax to gross income of a mutual insurance company without regard to underwriting losses, the Third Circuit said: "It is not necessary to uphold the validity of the tax imposed by the United States that the tax itself be an accurate label. . . . It could well be argued that the tax involved here is an 'excise tax' based upon the receipt of money by the taxpayer. It certainly is not a tax on property and it certainly is not a capitation tax; therefore, it need not be apportioned. . . . Congress has power to impose taxes generally, and if the particular imposition does not run afoul of any constitutional restrictions then the tax is lawful, call it what you will." *Penn Mutual Indemnity Co. v. Commissioner*, 277 F.2d 16 (3d Cir. 1960).

⁴⁸ *Supra* note 4.

⁴⁹ See, for example, *Lela Sullenger* and the dissenting opinion in *Pedone v. United States*, *supra* note 46.

⁵⁰ *Dean v. Commissioner*, 187 F.2d 1019 (3d Cir. 1951). See Int. Rev. Code of 1954, § 119.

Income may take the form of the discharge of a liability as well as the receipt of an asset.⁵¹ One of the most interesting kinds of gain which has been held to constitute income is the cancellation of a debt for less than the amount of the debt.⁵²

Gain is required for taxable income, but the gain need not be the gain of the taxpayer who is taxed upon the gain if there is some justifiable reason for taxing him upon it. Thus, apart from explicit statutory provision, the Supreme Court has held that compensation for personal services is taxable to the person who renders the services,⁵³ even though he irrevocably divests himself of any legal right to the compensation.⁵⁴ The income from a partnership may be taxed to the partner who actually produces the income, although someone else is legally entitled to it.⁵⁵ Income from property is taxable to the person who owns the property, even though he assigns the right to the income,⁵⁶ as long as he does not transfer the property or the estate which produces the income.⁵⁷

A statute taxing the income from a revocable trust to the grantor of the trust, although the income was paid to one other than the grantor, was held to be constitutional by the Supreme Court on the ground that a person who controls the disposition of income may properly be taxed as the owner of the income.⁵⁸ The basic notion behind this decision was extended still further by a lower court which held that the income from a revocable trust was taxable to the grantor of the trust apart from any statute imposing such a tax on the ground that, due to the control exercised over the income by the grantor, it really was his income.⁵⁹ Even before Congress explicitly taxed the income from short-term trusts to the grantor of the trust, the Supreme Court held in *Helvering v. Clifford*⁶⁰ that the income from such a trust was taxable to the

⁵¹ *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929).

⁵² *Kirby Lumber Co. v. United States*, *supra* note 5.

⁵³ *Lucas v. Earl*, 281 U.S. 111 (1930).

⁵⁴ *Helvering v. Eubank*, 311 U.S. 122 (1940). In a recent tax court case, however, the Tax Court held, with seven judges dissenting, that a person is not taxable upon a prize won in a contest, when he is not entitled to receive the prize but is required to designate another to do so. *Paul A. Teschner*, 38 T.C. 1003 (1963). *But see* Rev. Rul. 58-127, 1958-1 Cum. Bull. 42.

⁵⁵ *Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Lusthaus v. Commissioner*, 327 U.S. 293 (1946); *Commissioner v. Tower*, 327 U.S. 280 (1946). See Int. Rev. Code of 1954, § 704(e).

⁵⁶ *Harrison v. Schaffner*, 312 U.S. 579 (1941); *Helvering v. Clifford*, 309 U.S. 331 (1940).

⁵⁷ *Blair v. Commissioner*, 300 U.S. 5 (1937).

⁵⁸ *Corliss v. Bowers*, 281 U.S. 376 (1930).

⁵⁹ *McCauley v. Commissioner*, 44 F.2d 919 (5th Cir. 1930).

⁶⁰ *Supra* note 56.

grantor of the trust as the substantial owner of the trust property. This idea was subsequently extended by the lower courts to apply to a trust where the grantor retained no reversionary interest in the trust property, but had power to designate the beneficiaries of the trust,⁶¹ on the theory that the incidents of ownership represented by the power to change the beneficial enjoyment of the trust property was enough to justify treating the grantor as the owner of the trust income. The lower courts⁶² (and, of course, later the statute⁶³) have extended *Helvering v. Clifford* to tax the income of a trust to one other than the grantor of the trust, as the substantial owner of the trust property, where this person possesses power to call for the income or corpus of the trust. Perhaps the most extreme case of all, from the view point of taxing income to one person which belongs legally to another is *Burnet v. Wells*,⁶⁴ where at a relatively early date Mr. Justice Cardozo speaking in behalf of the majority of the Supreme Court held that it was constitutional to tax the income from a trust, which could be used to pay the insurance premiums of life insurance policies on the life of the grantor of the trust, to the grantor of the trust. Since the trust was irrevocable, there was no basis for arguing that the trust income should be taxed to the settlor of the trust because of his control over the trust income. Nor, since the settlor was not under a legal obligation to provide life insurance for the beneficiaries of the policies, could the Court invoke the doctrine that it was to invoke in *Douglas v. Willcuts*⁶⁵ several years later that the income was really the income of the grantor of the trust, because it was used to discharge his obligation. Instead, the Court reasoned that since the grantor of the trust had dedicated the income from the trust to keeping up his insurance, he received a continuing benefit that made it reasonable to tax the income from the trust to him. The basic approach to taxable income in *Burnet v. Wells* is a due process approach. Since Congress did not play the despot in taxing the income from the trust to the grantor of the trust, the tax was constitutional. Although *Burnet v. Wells* is an old case according to tax chronology, it perhaps comes closest of any decision to approximating the Supreme Court's present posi-

⁶¹ *Ingle v. McGowan*, 189 F.2d 785 (2d Cir. 1951); *Commissioner v. Buck*, 120 F.2d 775 (2d Cir. 1941).

⁶² *Grant v. Commissioner*, 174 F.2d 891 (5th Cir. 1949); *Commissioner v. Newman*, 159 F.2d 848 (2d Cir. 1947); *Mallinckrodt v. Nunan*, 146 F.2d 1 (8th Cir. 1945), *cert. denied*, 324 U.S. 871 (1945), *Cf.*, however, *Funk v. Commissioner*, 185 F.2d 127 (3d Cir. 1950).

⁶³ Int. Rev. Code of 1954, § 678.

⁶⁴ 289 U.S. 670 (1933).

⁶⁵ 296 U.S. 1 (1935).

tion on taxable income. Any gain may be taxed as income under the income tax if this is a *reasonable* thing to do.

There are several other interesting situations where a taxpayer is taxed upon a gain although he himself has no gain. For example, corporate distributions are taxed as dividends to the stockholders who receive them to the extent that the corporation has current earnings or earnings and profits accumulated after February 28, 1913. It is possible under this rule (which looks for gain to the corporation which distributes a dividend, rather than to the stockholder to whom it is taxed as income) to have a taxable dividend where the stockholder has no gain. For example, suppose that A purchased a share of stock in X corporation for \$200, which represented \$100 capital and \$100 earnings accumulated after February 28, 1913. The next day the corporation declares and distributes \$100 to A as a dividend and this distribution reduces the value of A's stock to \$100. Although A has no actual gain, but simply a return of part of his capital, he has taxable income of \$100.⁶⁶ A somewhat similar situation exists where a man gives away property which has appreciated while it is in his hands and the property is promptly sold by the donee. In this case the donee is taxed upon the gain, since he is required to use as his basis the substituted basis of the donor, rather than the fair market value of the property at the time he acquired it, although the property may not have increased in value after he received it.⁶⁷

The cases we have just been considering taxed a taxpayer upon a gain which belonged to someone else. There was, however, a gain. There are several cases where a taxpayer has been taxed upon income, where there actually was no gain, on the basis of a presumption or a legal fiction.

In *Helvering v. Midland Mutual Life Ins. Co.*,⁶⁸ a mortgagee bid in the mortgaged property at a foreclosure sale for the principal amount of the mortgage debt plus accrued interest. Although the fair market value of the property was worth less than the principal amount of the mortgage debt, the Supreme Court held that the mortgagee realized income to the extent of the interest obligations applied to acquire the property. The Court based its decision upon the presumption that the property was worth at least the amount

⁶⁶ In *United States v. Phellis*, 257 U.S. 156, 172 (1921), the Supreme Court rationalized the result on the theory that the taxpayer "simply stepped into the shoes . . . of the stockholder whose shares he acquired, and presumably the prospect of a dividend influenced the price paid, and was discounted by the prospect of an income tax to be paid thereon."

⁶⁷ *Taft v. Bowers*, 278 U.S. 470 (1928).

⁶⁸ 300 U.S. 216 (1937).

bid for it, and buttressed this argument with the reflection that the taxpayer had realized income from the interest obligation because he had used the obligation to step up the bid price, so that the mortgagor could not redeem the property for less than the principal of the debt and accrued interest.

In *Johnson v. Helvering*⁶⁹ a trustee sold unproductive property at a loss and distributed part of the proceeds of the sale to the income beneficiary as delayed income. The court held that the income beneficiary had realized taxable income from the trust, although the trust had a loss, upon the theory that the beneficiary and the trust were distinct, and the distribution in the hands of the beneficiary represented income to the beneficiary, regardless of any loss to the trust. The tax imposed in this case obviously contradicts the conduit theory of taxing trusts, and is no longer imposed under the provisions of the 1954 Code.⁷⁰

Another situation where the gain which will support the imposition of an income tax is a nebulous sort of gain involves the so-called claim of right doctrine. In *United States v. Lewis*,⁷¹ for example, the Supreme Court held that money paid to a taxpayer under a mistake was taxable to the taxpayer, if he honestly believed he was entitled to it, even though he later had to return the money. Instead of taking a transactional approach and holding that the later return of the money wiped out any income from the receipt of the money, the Court declared that each taxable period must be viewed separately and the taxpayer, therefore, realized income when he received the money and incurred a loss when he returned it.⁷²

The claim of right theory has been applied, with dubious propriety, to prevent an accrual basis taxpayer's deferring prepaid income until it is actually earned.⁷³ In *Commissioner v. Wilcox*,⁷⁴ the Supreme Court turned the claim of right theory around to hold that an embezzler did not realize income from the proceeds of an embezzlement, because he had not acquired them under a claim of right. The reasoning of the *Wilcox* case was repudiated in *Rutkin v. United States*,⁷⁵ which held that an extortioner was taxable under the income tax upon the proceeds of the extortion. In *James*

⁶⁹ 141 F.2d 208 (2d Cir. 1944). See *McCullough v. Commissioner*, 153 F.2d 345 (2d Cir. 1946).

⁷⁰ Int. Rev. Code of 1954, §§ 652, 662.

⁷¹ 340 U.S. 590 (1951).

⁷² The rule in the *Lewis* case, *supra* note 71, was modified by § 1341 of the 1954 Code.

⁷³ See *Schlude v. Commissioner*, 372 U.S. 128 (1963).

⁷⁴ 327 U.S. 404 (1946).

⁷⁵ 343 U.S. 130 (1952).

v. United States,⁷⁶ the Supreme Court rejected the result in the *Wilcox* case and held that the proceeds of an embezzlement are taxable as income to the embezzler. In these cases the Court found that there was a sufficient gain in the dominion which the taxpayers had over the wrongfully acquired property to constitute taxable income, despite the absence of a claim of right. Apparently this dominion must be coupled with an evil mind. Money which a man borrows is not income to the borrower, despite the control he possesses over the money, presumably because he intends to return it and it is lawfully acquired.

Consideration

After *Eisner v. Macomber*⁷⁷ declared that income was a "gain derived from capital, from labor, or from both combined," it was assumed that taxable income required consideration, and a wholly gratuitous receipt could not be taxed as income. This impression was strengthened by the fact that all of the federal income taxes since the sixteenth amendment have explicitly excluded gifts and bequests from gross income.⁷⁸

It was never particularly clear why a gratuitous receipt should not be taxed as income. The ability of a taxpayer to pay a tax due to a receipt is in no wise affected by its gratuitous character. Indeed it is arguable that there is more justification for imposing a tax upon a gratuitous receipt than there is in taxing something which the taxpayer has to work for. It is true that gifts are apt to be sporadic rather than recurrent, but recurrence has never been deemed an essential characteristic of taxable income.

Regardless of the merits of a tax upon gratuitous receipts, *Commissioner v. Glenshaw Glass Co.*⁷⁹ makes it clear that consideration is not an essential element of taxable income. In that case the Supreme Court held that punitive damages are taxable as income under the federal income tax.⁸⁰ Unfortunately for the commentator, the taxpayer conceded the constitutionality of the tax, so that was not in issue. The Court declared that as a matter of construction punitive damages fell within the 1939 Code defini-

⁷⁶ 366 U.S. 213 (1961).

⁷⁷ 252 U.S. 189 (1920).

⁷⁸ For the exemption of gifts under the current law see Int. Rev. Code of 1954, § 102. The 1894 income tax, which was held unconstitutional in the *Pollock* case, *supra* note 7, taxed personal property acquired by gift or inheritance. Seidman, Legislative History of Federal Income Tax Laws 1938-1861, 1017 (1938).

⁷⁹ 348 U.S. 426 (1955).

⁸⁰ A holding which the Service extends to punitive damages in personal injury actions where compensatory damages are not taxable. Rev. Rul. 54-418, 1958-2 Cum. Bull. 18.

tion of gross income taxing "gains or profits and income derived from any source whatever." The Court reasoned that the statutory language embraces all gains except those exempted by the statute. The only exemption that seemed even faintly relevant in the case of punitive damages was the exclusion for gifts, and the Court pointed out that it could not be seriously contended that punitive damages were a gift. As Mr. Justice Black summed up the holding in the *Glenshaw* case in *Commissioner v. LoBue*,⁸¹ "in defining gross income as broadly as it did in section 22(a) Congress intended to tax all gains except those specifically exempted."

It is possible to argue (although not very plausibly) that the *Glenshaw* case does not hold that a gratuitous receipt constitutes income. The argument would run something like this: in the *Glenshaw* case the Supreme Court did not say that punitive damages are income in the constitutional sense, because the constitutionality of the tax was conceded. The only question before the Court was whether punitive damages were taxed under section 22(a) of the 1939 Code, which imposed a tax on "gains or profits and income." The Court held that as a matter of construction punitive damages were a "gain" which was taxed under the statute, because they constitute a gain and they are not excluded from the tax imposed by the statute. There was no need to consider whether punitive damages are income in the constitutional sense, because this was not in issue. Moreover, even if punitive damages are not income in the constitutional sense, they are a gain which can be taxed constitutionally, because such a tax would not be a direct tax that requires apportionment.⁸²

Although the language in the *Glenshaw* case is not particularly precise, it seems obvious that the Court thought that punitive damages are taxable as income. This is apparent from the fact that the Court quoted section 61(a) of the 1954 Code, which defines gross income as "income from whatever source derived," without any reference to gains and profits, and noted that Congress had declared that this was the same definition of gross income, as far as meaning is concerned, as the definition in the 1939 Code.⁸³ The Court must have thought that "gain or profits" was simply a synonym for "income" as far as the 1939 Code definition of gross income was concerned, and that punitive damages fall within the statutory concept of income. They certainly would not have cited the 1954 Code definition of gross income and pointed out that

⁸¹ 351 U.S. 243, 246 (1956).

⁸² See *Penn Mutual Indemnity Co. v. Commissioner*, *supra* note 47.

⁸³ The Court quoted from the Committee Reports accompanying the 1954 Code, *supra* note 45.

Congress declared that it had simply re-enacted the 1939 definition, unless they felt that punitive damages were taxable under the 1954 Code. Of course, this is a matter that has more than academic significance. If "gains or profits" were not used as synonyms for income under the 1939 Code, it would be possible to argue that some of the things which were taxed under the 1939 Code cannot be taxed under the more restrictive language of the 1954 Code. It seems perfectly obvious, however, that the Supreme Court felt in the *Glenshaw* case that earnings and profits were synonymous with income and that taxable income includes any gain which is not specifically exempted by the statute. If the Court had felt that the change in the language effected by the 1954 code actually altered the definition of gross income under that Code, it is inconceivable that it would have cited the language of the 1954 Code along with the congressional reports stating that there was no change in meaning from the 1939 Code, without some dissenting comment.

The *Glenshaw* case makes it clear that it is constitutional to tax gratuitous receipts as income under the income tax. Although no one seems to have entertained any serious doubts upon the matter, this establishes the constitutionality of the tax imposed by the 1954 Code on prizes and awards, even though the recipient gave no consideration for the award.⁸⁴ It also eliminates any possible controversy over taxing fellowships above a stipulated amount⁸⁵ and the constitutionality of the provision taxing sick pay over and above the statutory exemption.⁸⁶

There has always been some confusion about what constitutes a gift that is exempt from the income tax where donor and donee stand in a business relation that makes it necessary to decide whether a particular payment represents a gift or compensation for services. This confusion was compounded when the Supreme Court held in *Commissioner v. Duberstein*⁸⁷ and the companion cases⁸⁸

⁸⁴ Int. Rev. Code of 1954, § 74. For a decision upholding the constitutionality of this section, see *Simmons v. United States*, 308 F.2d 160 (4th Cir. 1962). This, of course, changes the law prior to the 1954 Code when it was held that lack of consideration prevented a prize from being taxed as income. *Glenn v. Bates*, 217 F.2d 535 (6th Cir. 1954); *Campeau v. Commissioner*, 24 T.C. 370 (1955); *Washburn v. Commissioner*, 5 T.C. 1333 (1945).

⁸⁵ Int. Rev. Code of 1954, § 117.

⁸⁶ Int. Rev. Code of 1954, § 105.

⁸⁷ 363 U.S. 278 (1960).

⁸⁸ *Kaiser v. United States*, 363 U.S. 299 (1960); *Stanton v. United States*, 363 U.S. 278 (1960). For the subsequent history of the *Stanton* case, where it was finally held that the payment was exempt as a gift, see *Stanton v. United States*, 186 F. Supp. 393 (S.D.N.Y. 1960), *aff'd*, 287 F.2d 876 (2d Cir. 1961).

that the existence of a gift was a question of fact for the determination of the judge of the facts. The confusion created by the *Duberstein* case has spilled over into payments by an employer to the widow of a deceased employee and stirred up the uncertainty, always latent in that area, as to when such payments are taxed and when they represent a gift exempt from the income tax.⁸⁹ Since the *Glenshaw*⁹⁰ case makes it clear that there is no constitutional prohibition against taxing gifts as income, Congress might well intervene in these situations by providing that payments to widows above a specified statutory amount shall be taxed as income, and gratuitous payments between those standing in a business relation shall be rebuttably presumed to be compensation for services rather than a gift excluded from gross income.

The emphasis on constitutionality in this discussion may have created the impression that taxable income is purely a constitutional question. Of course, it is not. In some cases it is necessary to decide whether a particular gain is income in the constitutional sense to justify the constitutionality of the tax upon that item. In most cases, however, the question whether a particular gain is taxable as income arises in the context of construction in the course of a determination whether or not the federal income tax taxes the item under the statutory description of income. In this connection the new and expanded definition of income in the *Glenshaw* case could be important, because the constitutionality of the tax in that case was conceded and the Court's comment that any gain which is not expressly excluded by the statute is within the statutory definition of income was made with specific reference to the construction of the statute. In view of the Court's approach to taxable income in the *Glenshaw* case it seems pertinent to re-examine some of the dubious exclusions from gross income which have been made without any explicit statutory sanction. The Service has ruled for example, that social security benefits are not taxable as income,⁹¹ although they clearly are not gifts, and it is difficult to fit them into any explicit statutory exclusion. In much the same way, the exclusion of certain amounts paid to a taxpayer to reimburse him for some non-deductible expense, which have been excluded from gross income⁹² without any stat-

⁸⁹ Compare *Poyner v. Commissioner*, 301 F.2d 287 (4th Cir. 1962) with *Smith v. Commissioner*, 305 F.2d 778 (3d Cir. 1962) and *Martin v. Commissioner*, 305 F.2d 290 (3d Cir. 1962), cert. denied, 371 U.S. 904 (1962).

⁹⁰ *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

⁹¹ I.T. 3194, 1938-1 Cum. Bull. 114; I.T. 3447, 1944-1 Cum. Bull. 191 (old age and survivor's benefits); I.T. 3230, 1938-2 Cum. Bull. 136 (unemployment insurance); Rev. Rul. 57-102, 1957-1 Cum. Bull. 26 (public assistance to blind persons).

⁹² Rev. Rul. 57-60, 1957-1 Cum. Bull. 25 (reimbursement of parent by school

utory foundation for the exclusion, might be reconsidered. Of course, the taxation of imputed income might conceivably be called into question by the reasoning of the *Glenshaw*⁹³ case, since it is hard to deny that a man realizes a gain from the use of his own property and there appears to be no statutory provision for excluding such a gain from gross income. Although it is unlikely that imputed income will be taxed under the *Glenshaw* case, the exclusion of social security payments and the reimbursement for personal expenses, which were of dubious validity before the *Glenshaw* case, would appear to be indefensible after that decision.

Realization

The most interesting, and certainly the most controversial, aspect of the Supreme Court's decision in *Eisner v. Macomber*⁹⁴ was the proposition that gain must be realized before it is transmuted into income in the constitutional sense. There has been some confusion about realization because the term is used in several senses.

Since the income tax is imposed on income for a particular period it is necessary to have some standard for allocating income to one period rather than another. This is done by the taxpayer's system of accounting, and the resulting allocation is often described as realization. Thus, for example, an accrual basis taxpayer is said to realize income in the taxable period in which the right to the income accrues. Realization in this sense does not deal with the problem of the point at which gain is transmuted into income, but with the taxable period to which an item, admittedly income, is properly allocable. This was not, of course, the sense in which the Supreme Court used realization in *Eisner v. Macomber*.

Before the question arises as to the proper taxable period to which an item of income should be allocated, there is an anterior problem of whether a gain has become sufficiently fixed and definite to be treated as income and taxed under the income tax at all. When gain reaches the point where it becomes taxable as income, it is said to be realized. This is the sense in which the Supreme Court spoke of realization in *Eisner v. Macomber*.

The real point in *Eisner v. Macomber* was not, however, whether gain must be realized before it is taxed as income. Admittedly it must be. The real question in *Eisner v. Macomber*

board for transporting child to school when school bus not available); Rev. Rul. 54-249, 1954-2 Cum. Bull. 53 (reimbursement of moving expenses of employee assigned to new post by employer); Rev. Rul. 63-77, 1963 Int. Rev. Bull. No. 19 at 18 (reimbursement of job applicant's expenses in travelling for interview).

⁹³ Commissioner v. Glenshaw Glass Co., *supra* note 90.

⁹⁴ *Supra* note 77.

was who was finally to decide whether or not gain had reached the point where it was proper to tax it as income. Of course, if in a specific situation Congress does not decide this question, the courts must do so. When, for example, Congress said nothing about whether stock dividends were taxable as income in the 1913 act, the Supreme Court had to decide whether a stock dividend represented the kind of gain which it thought should be taxed under the income tax.⁹⁵ After Congress amended the law in 1916 explicitly to tax stock dividends as income, the question arose in *Eisner v. Macomber* whether the legislative judgment that a gain had reached the point where it might properly be taxed as income was final, or whether the decisive judgment in this area rested with the Supreme Court. In *Eisner v. Macomber* the Court arrogated to itself the final determination as to when a gain may properly be subjected to the income tax by treating this as a constitutional question rather than a matter of administrative convenience. The Supreme Court has intimated that *Eisner v. Macomber* was probably an error, and with the exception of an anomalous early reorganization case,⁹⁶ there does not seem to be any Supreme Court decision which has held that a gain was not taxable under the income tax because it had not been realized and was not income in the constitutional sense. The retreat from the position taken in *Eisner v. Macomber* has been obscured by the fact that realization is an essential requisite for taxable income, although it is probably not a constitutional requirement.

There is another common misunderstanding about *Eisner v. Macomber*. The constitutional requirement of realization, if it ever made any sense, did so only in connection with a tax on a gain from property which could be regarded as a tax on the property itself if it was not treated as a tax on income. In *Eisner v. Macomber*, the Court said that the stock dividend could not be taxed unless it was income in the sense of the sixteenth amendment, because if the tax did not impinge upon income, then it was a direct tax upon the property which produced the gain and was unconstitutional because it was not apportioned. A tax upon a gain which is not a direct tax upon property does not have to be sustained under the sixteenth amendment.⁹⁷ Consequently, even upon the assumption that realization is a constitutional prerequisite of income, such a gain need not be realized to be constitutionally taxable. There appears to have been some confusion on this point even in high places. For example, in *Helvering v. Inde-*

⁹⁵ *Towne v. Eisner*, 245 U.S. 418 (1918).

⁹⁶ *Weiss v. Stearn*, 265 U.S. 242 (1924).

⁹⁷ *Supra* note 47.

*pendent Life Insurance Co.*⁹⁸ Mr. Justice Butler declared: "The rental value of the building used by the owner does not constitute income within the meaning of the Sixteenth Amendment." The implication from this dictum is that a tax upon the rental value would be unconstitutional, since the subject taxed would not be income in the sense in which that term is used under the sixteenth amendment. If, however, the tax upon the use of the building is an indirect tax, in line with the Supreme Court's holdings with respect to taxes on the use of property⁹⁹ and on a single incident of property,¹⁰⁰ it would appear to be fully constitutional, since it would not have to be apportioned, and there would be no need to inquire whether or not the benefit to the taxpayer constituted income under the sixteenth amendment.

As long as there is an adequate gain to sustain an income tax, it would seem that the question of when this gain should be taxed, or when it was realized for tax purposes, should be a matter of administrative convenience to be decided by Congress, rather than a constitutional question whose ultimate resolution rests with the courts. Despite the fact that the Supreme Court has never explicitly overruled the contrary position it took in *Eisner v. Macomber*, the subsequent decisions of the Court appear to have abandoned the contention in *Eisner v. Macomber* that realization is a constitutional prerequisite of income.

Eisner v. Macomber defined a realized gain as a gain "severed from" the property which produced it. It soon became clear, however, that the severance was a legal fiction. Gain might be realized not only when appreciated property was sold, but even when it was exchanged and the gain and the capital which produced it remained indissolubly wrapped up in a single asset received on the exchange. Gain might also be realized when a debt was canceled for less than the amount of the debt, although it was difficult to see any severance of the gain from capital in this situation. In *Helvering v. Bruun*,¹⁰¹ the Supreme Court made explicit what had formerly been implied when it declared that realization does not require actual severance of gain from the property that produced it, but merely some event that freezes or fixes the gain with sufficient certainty so that it is proper to tax it. Thus, in holding that a lessor realized income from improvements made to the leased

⁹⁸ 292 U.S. 371, 379 (1934).

⁹⁹ *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796).

¹⁰⁰ *Knowlton v. Moore*, 178 U.S. 41 (1900) (inheritance tax); *New York Trust Co. v. Eisner*, 256 U.S. 345 (1921) (estate tax); *Bromley v. McCaughn*, 280 U.S. 124 (1929) (gift tax).

¹⁰¹ 309 U.S. 461 (1940).

premises by the lessee upon the termination of the lease, the Court declared: "While it is true that economic gain is not always taxable as income, it is settled that the realization of gain need not be in cash derived from the sale of an asset. Gain may occur as a result of exchange of property, payment of the taxpayer's indebtedness, relief from a liability, or other profit realized from the completion of a transaction."¹⁰² Although the Court may have implied that there was some constitutional requirement of realization in *Helvering v. Bruun*, in *Helvering v. Horst*,¹⁰³ decided shortly after *Helvering v. Bruun*, Mr. Justice Stone called realization a rule "founded on administrative convenience."

The decline of realization as a constitutional requirement is reflected in the area where the concept has had the greatest practical importance, that of corporate distributions.

The only case apart from *Eisner v. Macomber* in which realization as a constitutional requisite has prevented the imposition of an income tax was *Weiss v. Stearn*.¹⁰⁴ Before Congress amended the statute to exempt corporate reorganizations there was a series of five cases where, as a result of corporate reorganizations, stockholders received stock and securities in new corporations, whose value substantially exceeded the basis of the stock and securities in the old corporations. The Supreme Court was faced with the problem of determining whether the excess was taxable as income. Although there was no change in the substantial ownership of the corporate enterprise on the part of the stockholders in any of these cases, the Court held that they realized income in four of them¹⁰⁵ on the ground that they acquired a new or different interest in the reorganized corporation. The distinction between the four cases where the stockholders realized income and the single case¹⁰⁶ where they did not was formal rather than substantial. Even at this stage it was pretty obvious that the majority of the Supreme Court was seeking some escape from *Eisner v. Macomber*—*Macomber*—the single case that failed to distinguish *Eisner v. Macomber* was the anomalous case.

With the exception of the early reorganization cases and *Helvering v. Bruun*,¹⁰⁷ where the Supreme Court held that a lessor

¹⁰² *Id.* at 469.

¹⁰³ 311 U.S. 112, 116 (1940).

¹⁰⁴ *Supra* note 96.

¹⁰⁵ *Marr v. United States*, 268 U.S. 536 (1925); *Cullinan v. Walker*, 262 U.S. 134 (1923); *Rockefeller v. United States*, 257 U.S. 176 (1921); *United States v. Phellis*, *supra* note 66.

¹⁰⁶ *Weiss v. Stearn*, *supra* note 96.

¹⁰⁷ *Supra* note 101.

realized income from improvements made to the leased premises by the lessee when the lease terminated, the only cases in which realization has played a prominent part have been the later stock dividend cases. After the Supreme Court held in *Eisner v. Macomber* that a stock dividend in the form of common on common was not taxable as income, Congress amended the statute in 1921 to provide explicitly that stock dividends should not be subject to the income tax. The Treasury construed the exemption to embrace all stock dividends, not merely the common on common dividend involved in *Eisner v. Macomber*. At the same time the Regulations provided that a stockholder might realize income from the sale of a stock dividend or his original stock, and that in determining such gain he should take as his basis for the dividend and the original stock the cost of the original stock allocated between the dividend and the original stock according to their respective market values. This seemed a satisfactory solution of the stock dividend problem until the Supreme Court suddenly discovered a distinction between income stock dividends and non-income stock dividends. In *Koshland v. Helvering*,¹⁰⁸ the taxpayer owned preferred stock. She received a dividend in common stock upon her preferred stock, which was then redeemed by the corporation. The Commissioner contended that the taxpayer had to allocate part of the basis of her original preferred stock to the common stock dividend in computing her gain from the redemption of the preferred stock. But the Supreme Court held that this was not required. The Court said that the stock dividend was essentially income, although exempt from tax under the statute, and the statute did not provide for allocating part of the basis of the original stock to an income dividend. After this decision Congress amended the statute in 1936 to provide that stock dividends should be taxed to the extent that they were constitutionally taxable, and another chapter started in the history of the tax on stock dividends, in which the principal theme was the distinction between taxable and non-taxable stock dividends.

In *Helvering v. Griffiths*,¹⁰⁹ the first case to reach the Supreme Court under the 1936 tax on stock dividends, the government sought to tax a dividend of common on common, contending that *Eisner v. Macomber* was wrong, and that, as far as the Constitution was concerned, all stock dividends were taxable as income. The Supreme Court did not deny this directly. In fact it conceded it tacitly, although it held that the particular dividend in the *Griffiths* case was not taxable. The Court said that when Congress provided

¹⁰⁸ 298 U.S. 441 (1936).

¹⁰⁹ 318 U.S. 371 (1943).

that stock dividends were not taxable to the extent that they were not constitutionally taxable it had *Eisner v. Macomber* in mind, and intended to incorporate the rule of *Eisner v. Macomber* into the statute. The rule that Congress intended to enact was that stock dividends should not be taxed as income unless they gave the stockholder a new proportional interest in the corporation.¹¹⁰ In other words, the Court implied that any stock dividend could constitutionally be taxed as income; but, because Congress intended to incorporate the rule of *Eisner v. Macomber* into the statute, it held that an *Eisner v. Macomber* stock dividend was not taxable under the statute, as a matter of construction rather than constitutionality. The 1954 Code took a new approach to the taxation of stock dividends and provided that stock dividends, with several minor exceptions, should not be taxed under the income tax.¹¹¹ The exemption of stock dividends from the income tax does not, of course, present any constitutional problem, since even in the most prosperous days of *Eisner v. Macomber* no one ever thought that the doctrine of realization worked in reverse to require Congress to tax realized gain as income. Under *Eisner v. Macomber*, Congress could not tax a gain until it was realized. However, there is no constitutional prohibition against Congress refusing to recognize and tax a realized gain, if it does not see fit to do so.

Although it appears that as a constitutional prerequisite realization is no longer required, it is, of course, possible that the Supreme Court, which has never explicitly repudiated *Eisner v. Macomber*, may revive the requirement of realization as an indispensable ingredient of income in the constitutional sense. If this happens, the four most likely situations where it might occur seem to be: the taxation of undistributed corporate profits to stockholders; the taxation of gratuitous dispositions; the taxation of paper profits; and the taxation of imputed income. It is interesting to speculate briefly about the possible influence of realization in these areas.

Despite the fact that *Eisner v. Macomber* explicitly rejected *Collector v. Hubbard*,¹¹² which had upheld the constitutionality of taxing stockholders directly upon their pro rata shares of the undistributed profits of the corporation under the Civil War income tax acts, there are several provisions under the federal income

¹¹⁰ For the subsequent application of this rule see *Helvering v. Sprouse and Strassburger v. Commissioner*, 318 U.S. 604 (1943); *Chamberlain v. Commissioner*, 207 F.2d 462 (6th Cir. 1953); *Wiegand v. Commissioner*, 194 F.2d 479 (3d Cir. 1952).

¹¹¹ Int. Rev. Code of 1954, § 305.

¹¹² 79 U.S. (12 Wall.) 1 (1870).

tax which tax stockholders upon undistributed corporate profits. The statutory provisions taxing the undistributed income of a subchapter S corporation directly to the stockholders of the corporation¹¹³ do not appear to present any constitutional difficulties in view of the stockholder election required to invoke the tax. The provisions for taxing the undistributed income of foreign personal holding companies to United States shareholders¹¹⁴ lack the voluntary aspect of the tax on subchapter S corporations, but as a reasonable method of preventing tax avoidance it seems fairly certain that their constitutionality will be upheld in the face of any quibbles about realization. The same idea appears to apply to the provisions taxing the income of United States shareholders upon the undistributed income of controlled foreign corporations.¹¹⁵ It is hardly conceivable that reasonable methods of preventing tax avoidance such as these will be invalidated under any constitutional doctrine of realization.

Ever since the Supreme Court in *Helvering v. Horst*¹¹⁶ (wherein a father gave his son unmatured bond coupons without parting with the bonds to which the coupons had been attached and was taxed upon the interest represented by the coupons) intimated that income might be realized from a gift of a right to income, there has been a good deal of talk about the possibility of realizing income from a gratuitous disposition. Actually the problem here does not seem to be one of realization but of gain. When the taxpayer disposes irrevocably of a right to income or appreciated property, he has completed the transaction by which income would be earned if there were any, and thus realizes income in the sense in which the Supreme Court used that term in *Helvering v. Bruun*.¹¹⁷ The real question is whether the taxpayer has a sufficient gain to justify taxing him under the income tax. Realization appears to be used in connection with cases of this kind in the loose sense of an indication of the presence of taxable income, rather than the stricter sense of completion of a transaction or a definitive change in the taxpayer's economic status.

The difficulty in finding taxable income where a taxpayer disposes of property gratuitously lies in discovering any gain or income, since the disposition appears to involve *outgo* rather than *income*. In this connection it is important to distinguish several situations. There are a number of cases under the statute where

¹¹³ Int. Rev. Code of 1954, §§ 1371-1377.

¹¹⁴ Int. Rev. Code of 1954, §§ 551-558.

¹¹⁵ Int. Rev. Code of 1954, §§ 951-964.

¹¹⁶ *Supra* note 103.

¹¹⁷ *Supra* note 101.

a taxpayer is taxed upon income when he disposes of property gratuitously, not because of any gain accruing to him as the result of the disposition, but because of some anterior transaction which resulted in an income tax advantage that he is now called upon to account for. There is no question about the propriety of the imposition of the income tax in these situations. For example, the statute requires a taxpayer who has made an installment sale and elected to report the gain from the sale under the installment method to report as taxable income, when he gives away the installment obligations, the excess of the fair market value of the obligations given away over their basis.¹¹⁸ Obviously, the justification for the tax here is not any gain which the taxpayer makes from the gift of the installment obligations, but the original gain which he realized when he made the installment sale, upon which the postponement of the tax is no longer allowed. The same situation exists in connection with the income which is taxed when an employee gives away a stock option,¹¹⁹ or a person who has inherited income in respect of a decedent gives away the right to such income.¹²⁰ In all of these cases the gain which is taxed is not any gain from the gift, but the gain from some earlier transaction whose taxation was postponed until the taxpayer made the gift. A somewhat similar situation occurs where a tax is imposed in connection with a gratuitous disposition of property because the disposition requires a readjustment of some deduction or credit previously allowed the taxpayer. For example, when a liquidating corporation distributes certain kinds of property in connection with which it deducted post-1961 depreciation it is required to include the amount of the depreciation as ordinary income to compensate for the deduction previously taken.¹²¹ When a taxpayer has taken against his tax an investment credit based upon an estimated life for the asset in connection with which the credit is claimed and subsequently gives the asset away before the expiration of its estimated life, he is required to recompute the credit and add the part to which he was not entitled to his tax for the year in which he disposed of the property.¹²² It seems clear that it is permissible to impose an income tax when property is given away to compensate for some tax advantage the taxpayer previously obtained. The tax

¹¹⁸ Int. Rev. Code of 1954, § 453(d)(1).

¹¹⁹ Int. Rev. Code of 1954, §§ 421(b), (d)(4)(A) (restricted stock options).
See Treas. Reg. §§ 1.421-6(d)(4), (5) (other options).

¹²⁰ Int. Rev. Code of 1954, § 691(a)(2).

¹²¹ Int. Rev. Code of 1954, § 1245(a)(1)(B)(ii).

¹²² Int. Rev. Code of 1954, § 47(a)(1). The same rule applies to changes in the character of the property without any disposition. Int. Rev. Code of 1954, § 47(a)(2).

advantage represents a sufficient gain to sustain an income tax. Thus, for example, when property which has appreciated in value is given to charity the taxpayer is allowed to deduct the fair market value of the appreciated property,¹²³ so that he gets the benefit of the unrealized appreciation without being required to include it in his gross income. It would appear to be fully constitutional, however, to limit the taxpayer to a deduction equal to the basis of the property¹²⁴ or to achieve the same result by the technique of requiring the taxpayer to include the appreciation in his gross income. The cases which refused to sanction this result involved construction, not constitutionality.¹²⁵

Where a taxpayer gives away a right to income or property that has appreciated in value and the only advantage he obtains from the gift is the possibility of escaping a tax on the right to income or the appreciation in the value of the property, it is not clear whether he may be subjected to an income tax. Of course, if he gives away a right to income without parting with the principal which produced the income, he will be taxed upon the income represented by the right, when it is collected, upon the theory that he has not divested himself effectively of the right to income for tax purposes.¹²⁶ Even if he gives away the principal which produces the income, he will be taxed upon any income given away which had accrued¹²⁷ or become due and payable before the gift,¹²⁸ on the theory that he actually realized this income before he gave it away. In *Helvering v. Horst*,¹²⁹ a father gave bond coupons before they matured to his son and it was held that the donor was taxable upon the interest from the coupons, apparently when they were collected by the donee. Mr. Justice Stone said that the father realized income when he gave away the bond coupons because he

¹²³ Rev. Rul. 59-196, 1959-1 Cum. Bull. 56.

¹²⁴ The existing law requires the amount of a charitable contribution deduction to be reduced by any prepaid interest and certain depreciation in connection with section 1245 and section 1250 property. Int. Rev. Code of 1954, §§ 170(b)(4), (e).

¹²⁵ *Campbell v. Prothro*, 209 F.2d 331 (5th Cir. 1954) and *White v. Brodrick*, 104 F. Supp. 213 (D. Kan. 1952) refused to follow I.T. 3910, 1948-1 Cum. Bull. 15, where the Service ruled that a taxpayer realized income when he contributed wheat that he had raised to charity. Subsequently, I.T. 3910 was revoked. Rev. Rul. 55-138, 1955-1 Cum. Bull. 223.

¹²⁶ *Harrison v. Schaffner*, 312 U.S. 579 (1941).

¹²⁷ *Smith's Estate v. Commissioner*, 292 F.2d 478 (3d Cir. 1961), *cert. denied*, 368 U.S. 967 (1962); *Austin v. Commissioner*, 161 F.2d 666 (6th Cir. 1947); *Anthony's Estate v. Commissioner*, 155 F.2d 980 (10th Cir. 1946). *Cf.*, however, *Bishop v. Shaughnessy*, 195 F.2d 683 (2d Cir. 1952); *Commissioner v. Timken's Estate*, 141 F.2d 625 (6th Cir. 1944).

¹²⁸ Rev. Rul. 58-275, 1958-1 Cum. Bull. 22.

¹²⁹ *Supra* note 103.

used the right to income to obtain the satisfaction of making a gift. It is easier to reconcile the result of the case with the doctrine that income remains taxable to the assignor when he assigns a right to income from property without transferring the property which produces the income, than it is with Mr. Justice Stone's theory that income is realized from a gift of a right to income because of the emotional satisfaction derived from making a gift. Stone analogized the situation to a case where a bondholder realizes income from bond coupons that he uses to buy groceries or pay a debt. The analogy is not perfect since in these cases the income which the bondholder realizes consists of the groceries he receives or the liability which he discharges. When a bondholder gives away bond coupons, he does not receive anything in return apart from the emotional satisfaction of making a gift. Mr. Justice Stone conceded that the father would not have realized income in *Helvering v. Horst* if he had given away the bonds as well as the coupons. This concession is easier to reconcile with the theory that *Helvering v. Horst* is an assignment case rather than a "realization" case. From the viewpoint of liability for the income tax on assigned income, if the taxpayer in *Helvering v. Horst* had given away the bonds as well as the coupons, he would no longer have been taxable upon the income from the bonds, and this income would have been taxed to the donee or assignee. If, however, he experiences a taxable satisfaction when he gives away a right to income, it is difficult to see why this satisfaction should not be treated as income when it is accompanied by a gift of the bonds. It is generally assumed that the taxpayer in *Helvering v. Horst* realized income from the bond coupons when they were collected by his son.¹³⁰ If this assumption is sound, it would appear that the case is an assignment case where the income collected by the son remained taxable to the father. If the father realized income when he gave away the coupons, he should have realized this income at the time of the gift. Certainly, if he had used the coupons to buy groceries, he would have realized income when he purchased the groceries, rather than when the grocer cashed in the coupons.

The difficulty in finding taxable income when a man gives away a right to income does not appear to lie in realization, because there is a final disposition of the right to income, which would justify imposing a tax at that time, if there were a sufficient gain to sustain the tax. The real difficulty seems to be finding a sufficient gain to justify the imposition of an income tax. Of course, a right to income, or an appreciation in the value of property, rep-

¹³⁰ See *Austin v. Commissioner*, *supra* note 127.

resents at least a potential gain, and perhaps this is a sufficient basis for the tax. This appears more vividly in the case of something tangible like agricultural commodities than it does in the case of a bond coupon. Suppose, for example, that a wheat farmer raises a wheat crop and gives the crop to his son. One could argue that the father had a gain when he raised the crop, and Congress has power to tax the gain when he gives it away if it sees fit. Whether one says that a right to income or an appreciation in the value of property represents a gain or a potential gain, it probably is a sufficient basis for the imposition of an income tax as far as the constitutionality of the tax is concerned.¹³¹ It is doubtful if the present statute could be fairly construed to treat a gift of appreciated property or a right to income as a realization of income.¹³² If, however, the statute provided explicitly for a tax in this situation, there seems to be sufficient basis for the tax to uphold Congress' decision to impose a tax and to treat it as constitutional. Otherwise the Court would fall back into the error it made in *Eisner v. Macomber*, when it held that the final judgment of what kind of gains may be taxed under the income tax rests with the courts rather than Congress.

It has been suggested that one solution for the problem of taxing capital gains which are earned over a number of years and realized in a single taxable period would be to require the taxpayer to inventory his assets at the beginning and the end of the taxable year and pay a tax on any net increase, with presumably the privilege of deducting any net decrease, in the value of his assets. This presents the question of realization because there has been no completed transaction, as well as the question of whether a potential gain is sufficient gain to sustain an income tax. The administrative difficulties in connection with such a plan are so great that it is unlikely that Congress will ever adopt it. If Congress did, the Supreme Court might sustain its constitutionality out of deference to the legislative judgment as to the appropriate time to impose an income tax. To a limited extent, of course, unrealized appreciation in the inventory value of goods is taxed under the current code where goods are inventoried on the basis of market values and used to determine the cost of goods sold. No one seems disturbed about the constitutionality of this practice.

The administrative problems connected with taxing a man

¹³¹ However, although the Service ruled that a taxpayer realized income when he gave calves produced by his cows to his son (I.T. 3932, 1948-1 Cum. Bull. 7), the courts refused to follow this ruling. *Campbell v. Prothro*, *supra* note 125; *Elsie Sorelle*, 22 T.C. 459 (1954); *Estate of Farrier*, 15 T.C. 277 (1950).

¹³² See note 131 *supra*.

upon the use of his own property as income are obvious. The difficulty here does not rest on realization, because it would seem that a tax upon the use of property is an indirect tax, which can be imposed without apportionment,¹³³ regardless of whether the subject of the tax is income in the constitutional sense or not. There are, moreover, obvious inequities in omitting imputed income from the income tax, which could be urged in favor of the constitutionality of such a tax.¹³⁴

Conclusion

It is possible that we have made a mistake in seeking to define taxable income in terms of some economic objectivity instead of treating it as a juridical concept resting upon considerations of policy. When a court decides that taxable income exists in a specific case it goes through the same process as it does when it decides a tort or contract case. In the tort or contract case, the question facing a court is whether it is just and socially expedient to subject the defendant to a liability for tort or breach of contract. In a tax case the question confronting the court is whether it is just and proper to subject the taxpayer to liability for an income tax. Perhaps a fitting approach to taxable income is to think of it as an occasion on which it is just and socially sensible to impose liability for an income tax, rather than as some particular kind of economic entity. From this point of view the constitutionality of taxing a particular item as income resolves itself into an inquiry into whether Congress has acted reasonably in imposing the tax. The question of construing the word "income" in a tax statute to include a particular gain becomes a question of whether or not such a construction will achieve a just and socially desirable result.

¹³³ *Supra* notes 99 and 100.

¹³⁴ For example, if two taxpayers each have \$25,000 and one invests this sum in a personal residence, while the other invests in stocks and uses the dividends from the stocks to rent a residence, the first taxpayer will not have any taxable income, while the second taxpayer will be required to report the dividends from the stocks as income and will not, of course, be entitled to deduct the rent of the residence, since this is a personal expense.